



Committee on the Budget • Majority Caucus
U.S. House of Representatives
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Economic Update

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Volume 3, Number 2

10 February 2004

Good News on the Economy Continues Jobs Data Show Moderate Gain

Good economic data continue to flow in, reinforcing the view that the economy has entered a period of stronger, sustained expansion. This is also reflected in the new Blue Chip forecast released today (see below). The one area of particular concern – labor markets and payroll jobs – showed further evidence of improvement, with the unemployment rate and new claims for unemployment insurance continuing at lower levels, small businesses reporting increased hiring plans, and payroll jobs showing a trend of growing job creation.

Nevertheless, payroll jobs growth has lagged behind expectations as the extraordinarily strong labor productivity growth of recent years has allowed strong output growth without large increases in employment at business establishments.

Good News on the Economy

The news coming in about the economy confirms the strengthening expansion:

- *Real gross domestic product [GDP] growth* was 4.0 percent at an annual rate in the fourth quarter of 2003 following the 8.2 percent growth rate in the third quarter of 2003 – the highest pace in two decades. Real GDP growth during the second half of 2003 was at a 6.1 percent annual rate – the highest two-quarter growth in two decades as well.
- *Consumer sentiment* surged in January to a 3-year high – and the highest one-month gain in 11 years.
- *Manufacturing activity* soared at the end of 2003 – to the highest pace of activity in 20 years.
- *Housing starts* are at their highest level in 20 years. *The homeownership rate* is at a record high.
- *Industrial production* rose at a 6 percent annual rate during the second half of 2003, its fastest 6-month rate of increase in 3½ years.
- *Real fixed business investment* rose at a 10-percent annual rate over the second half of 2003 and *real business equipment investment* rose at a 14 percent annual rate over that period – their fastest rates of 6-month growth in over 2½ years.
- *U.S. real exports of goods and services* rose at a 19 percent rate in the fourth quarter, the best in 7 years.
- *Stock markets* have increased significantly: the Dow Jones industrials are up 40 percent since last March.
- *The unemployment rate* fell to 5.6 percent in January – a 2-year low – and down from 6.3 percent last June.
- *Unemployment Insurance [UI] claims* are down, running at their lowest levels in 3 years. UI claims have been below 400,000 (the level typically associated with a flat labor market) for 17 straight weeks, indicating an improving labor market.
- *Employment* is up by nearly 800,000 from before the recession (as measured by the household survey which includes the self-employed and which is not subject to the downward measurement bias for new business employment as in the establishment survey). Recently revised data for nonfarm *payroll employment* show jobs increased by 112,000 in January, with 366,000 jobs added over the past 5 months.
- *Net hiring plans* by small businesses surged in December to a near-record high and the highest level since 1999, according to the National Federation of Independent Business survey.

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- *Interest rates* are low. Mortgage rates have been running at their lowest levels in more than 3 decades; the bank prime is at its lowest level in 45 years.
- *Inflation* is low. Consumer price inflation (CPI and core CPI, excluding food and energy) has been running at its lowest rate in nearly 4 decades.

Even with all this good news, concerns remain about the lagging performance of payroll jobs. Typically, with real GDP growth as strong as it has been, much higher growth in payroll jobs should be expected – as in most other early expansion periods. The sluggish jobs performance appears to result from a combination of factors, including: strong growth in labor productivity (the output produced per labor input) and possible measurement errors (the failure of official government payroll jobs numbers to properly capture jobs created by new business establishments). Even so, most forecasters expect that stronger jobs growth will occur soon in response to the recent surge in the economy.

The Role of Tax Relief

Over the past 3 years, three major tax relief bills became law. Those packages played important roles in keeping the adverse effects of the 2000-01 slowdown and recession milder than otherwise would have been the case – and have helped to boost the economy to its recent strong performance. Last year's tax relief legislation, the Jobs and Growth Tax Relief Reconciliation Act of 2003 [JGTRRA] accelerated the scheduled income tax relief and tax rate reductions of the 2001 tax relief legislation, increased the "bonus depreciation" business investment tax incentives, and reduced dividend and capital gains tax rates. Significant tax relief occurred in the second half of 2003, including advance payments for child tax credits in the form of checks mailed to taxpayers in July and August. The tax relief generated significant stimulus for the economy, with real consumption spending registering its strongest gain in 18 years in the third quarter. In addition, although the tax relief applied to year 2003 as a whole, withholding schedules were only put into effect at mid-year. As a result, significant tax refunds will occur early this year that will help to further boost households after-tax income – and likely contribute to additional increases in spending.

Outlook for Continued Strong Growth

With the recent strength of major economic indicators – and the outlook for continued low interest rates as well as additional stimulus from tax relief – private forecasters anticipate that the economy will continue to grow strongly (see table). The Blue Chip economic outlook projects real GDP growth to continue in the 4- to 4-½ percent range during 2004 and for real growth to be around 3½ percent during 2005. The unemployment rate is expected to decline to 5.5 percent by the end of 2004, and to decline further to 5.3 percent by the end of 2005. Inflation and interest rates are expected to rise gradually as the economy improves.

Blue Chip Economic Outlook, February 2004										
	2003.3	2003.4	2004.1	2004.2	2004.3	2004.4	2005.1	2005.2	2005.3	2005.4
	<i>Actual</i>		<i>Projection</i>							
Real GDP Growth	8.2	4.0	4.5	4.3	4.1	3.9	3.6	3.6	3.6	3.5
Unemployment Rate	6.1	5.9	5.8	5.7	5.6	5.5	5.4	5.4	5.3	5.3
CPI Inflation	2.4	0.9	2.1	1.7	1.8	1.9	2.0	2.1	2.2	2.3
3-month Treasury Bill	1.0	0.9	1.0	1.1	1.3	1.6	2.0	2.3	2.7	3.1
10-year Treasury Note	4.3	4.3	4.3	4.5	4.7	4.9	5.1	5.2	5.4	5.5

Monetary Policy and Greenspan Congressional Testimony

After its January policy meeting, the Federal Open Market Committee [FOMC] released its policy statement, and removed the prior reference that "the Committee believes that policy accommodation can be maintained for a considerable period." Instead, the January statement said: "[T]he Committee believes that it can be patient in removing its policy accommodation." The phrase "considerable period" had been given special value in the financial markets. Its removal generally is viewed as a signal that the FOMC recognizes the economy is improving and that policymakers viewed future policy changes as dependent on the performance of the economy and not a specified length of time. Federal Reserve Chairman Greenspan is scheduled to give the semi-annual monetary policy report before House and Senate Committees this week. As always, his testimony will be carefully followed for information about the current views of monetary policy makers regarding the economy and the likely future path of monetary policy.

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